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No. 93-1987

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

SHARON PRATT KELLY, *et al.*,
Petitioners,
v.
SPRINT COMMUNICATIONS COMPANY, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE DISTRICT OF COLUMBIA COURT OF APPEALS

REPLY TO BRIEF IN OPPOSITION

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I. This Case Is Important to Clarify that a State Tax Scheme Will Not Be Held Invalid Under the Commerce Clause Unless it Discriminates against Interstate Commerce in Some Significant Way.

As we showed in the petition, the District of Columbia tax statute at issue in this case is a fairly apportioned gross receipts tax on interstate telephone calls. Calls originating or terminating in the District and billed to a District number are taxed. In order not to burden a second time the interstate activity subject to the gross receipts tax, those companies subject to the tax who have personal property in the District are relieved of the District's personal property tax to the extent that this personal property is used to generate the gross

receipts subject to the gross receipts tax. As we showed, the legislative choice to exempt only so much personal property as was used to generate gross receipts subject to the tax avoided creating a double tax burden on carriers with personal property in the District, on the one hand, but avoided creating an undue tax advantage for carriers simply because they have personal property in the District, on the other. In other words, the exemption was tailored to avoid double taxation and not to benefit businesses for locating in the jurisdiction.

The court below held that the District's tax was constitutionally infirm under the Commerce Clause because the personal property tax exemption was tailored in this way. The court below felt that it was constrained by this Court's precedents to do so, particularly the internal consistency test as applied in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987).

We have sought review here because the District's tax at issue does not discriminate against interstate commerce in any significant way. The fact that it can be considered to do so under the Court's precedents simply demonstrates how badly this area of the Court's jurisprudence needs reexamination or clarification. In brief, our argument is that, if this Court's precedents do require the invalidation of this tax scheme, they have become so disconnected from the purposes of the Commerce Clause that they should be reconsidered; if the Court's precedents do not require that result, the fact that the Court below thought that they did shows that the Court must clarify its doctrine in this area.

Respondents' opposition to our petition underscores our point. Our petition showed that, unlike the state tax in *Tyler Pipe*, the District's tax scheme here does not prefer interstate to intrastate commerce because the District's tax only involves

interstate commerce; telephone calls that cross state lines. Pet. at 22-23. However, the respondents argue that, under this Court's precedents, the District's tax scheme must be treated as "creating an incentive to produce in a state only what it sells there." *Id.* at 23. In other words, according to respondents, this Court's precedents require the District's scheme to be treated as if it preferred intrastate commerce even though it does not do so in fact. The court below relied on that argument in holding this tax invalid. App. at 23a.

More important, the evil that respondents identify in the District's tax is that it "creat[es] an incentive for a long-distance telephone company to ... locate[] in the District, rather than elsewhere, the personal property used or consumed in processing the taxable receipts it realizes there." Opp. at 18. This, respondents argue, is impermissible because it contravenes this Court's holdings in *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977) and *Westinghouse Electric Corp. v. Tully*, 483 U.S. 232 (1987). *Id.* at 23-24. However, *Boston Stock Exchange* and *Westinghouse Electric Corp.* invalidated tax schemes which benefitted companies more to the extent that they did more business in the jurisdiction. Respondents recognize that the tax here does no such thing. Indeed, they argue that this tax is bad because it penalizes interstate businesses who concentrate their personal property in any one jurisdiction. *Id.* at 20. In fact, they argue that this tax is bad precisely because, if adopted everywhere, it would reward a company "which spread its facilities among the several states." *Id.* We have argued that the notion that a personal property exemption that works as this one does will in fact cause companies to disperse their personal property is far-fetched in the extreme. Pet. at 20-21. But, it is certainly a strange notion that a tax which results in a company spreading its facilities in many states--which would seem to promote

commerce between the states--somehow disadvantages inter-state commerce.

What respondents' objection seems really based on is the notion that a state tax must be structured so that it does not affect a firm's decisions about where to do business. See Opp. at 21 ("such a formula geographically constrains a multi-state operation in locating its investment and the states in which it makes sales"). However, as we pointed out in the petition (at 23), this Court has repeatedly emphasized that a state may purposely design its tax system to promote in-state investment. Accordingly, even respondents grudgingly concede that "fair encouragement of economic activity within its jurisdiction" is permissible. Opp. at 24. The real question then is what sorts of effects on business decisions are "unfair."

What respondents say is unfair is the District's failure to exempt from its personal property tax all the personal property of the communication carriers in the District because "such an unrestricted exemption . . . would be available to one and all, whether they used such property in connection with calls that might generate receipts in some neighboring jurisdiction or whether they used it to produce calls that generated receipts only in the District." Opp. at 24. In other words, the only fair tax is one which rewards most companies who concentrate the most personal property in the District. That cannot be required by a constitutional provision intended to prohibit state protectionism.

Both the ruling below and respondents' arguments demonstrate that this Court's decision in this area are no longer perceived as grounded in preventing preferences for intra-state commerce or intra-state businesses. This case provides an excellent vehicle for clarifying that it is only such important

federal purposes which can justify a court invalidating a state tax statute under the Commerce Clause.

II. The Petition Is Not Premature; the Court Has Jurisdiction under 28 U.S.C. § 1257.

The respondent telephone companies argue that the petition is premature, asserting that the judgment of the District of Columbia Court of Appeals is not final under 28 U.S.C. § 1257. Opp. at 12-14. The argument should be rejected, because the Court of Appeals' decision has practical finality.

Jurisdiction is present under 28 U.S.C. § 1257 (a), which authorizes the Court to review "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had . . . by writ of certiorari . . . where the validity of a statute of any State is drawn into question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States . . .." The District of Columbia Court of Appeals is the "highest court of a State" for purposes of this section. 28 U.S.C. § 1257 (b). The Court has adopted a pragmatic and flexible approach to finality under the section and has recognized at least four categories of cases in which state court judgments have been found to be final under the section even though they did not terminate the litigation. *Cox Broadcasting Corp. v. Cohn*, 420 U. S. 469, 476-87 (1975); *Brown Shoe Co. v. United States,* 370 U.S. 294, 306 (1962).

The decision of the Court of Appeals is a final decision of the highest court in the District of Columbia. Its declarations that the District of Columbia Council had authority under the Constitution and under local law to enact the tax and that the tax is unconstitutional because it violates the Commerce Clause are final decisions that are not subject to further consideration or review under local law. The only issue present-

ed to the Court of Appeals that it did not decide concerned the retroactivity of the tax. There was no need to decide that issue in light of the declaration that the tax violates the Commerce Clause. Retroactivity is an issue in the case only if there is a constitutional statute.

The Court of Appeals remanded the case to the Superior Court for further proceedings; however, the next step contemplated by the Court of Appeals' decision is the enactment by the District of Columbia Council, the District's legislature, of an amendment to the tax on the long-distance companies to repair the unconstitutionality that was found. App.at 25-26. This aspect of the decision conforms to recent decisions of this Court. See, *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 51-52 (1990); *Harper v. Virginia Dep't of Taxation*, 113 S.Ct. 2510, 2520 (1993); and *Associated Industries of Missouri v. Lohman*, 114 S.Ct. 1815, 1825 (1994). The only trial court order that will be appropriate on remand, at least initially, is an order that will trigger legislation by the District of Columbia Council to repair the unconstitutionality found by the Court of Appeals. The telephone companies may challenge any retroactive features in the amended statute.

The Court of Appeals' decision is within the third category recognized in *Cox Broadcasting Corp.* as being final under § 1257(a): "where the federal claim has been finally decided, with further proceedings on the merits in the state courts to come, but in which later review of the federal issue cannot be had, whatever the ultimate outcome of the case." 420 U.S. at 481; *see also, North Dakota State Board of Pharmacy v. Snyder's Drug Store, Inc.*, 414 U.S. 156, 162-163 (1973). Once the District's legislature amends the statute, any further proceedings in the case will concern the amended statute. It is highly doubtful that the District of Columbia could then

obtain review of the decision holding unconstitutional the current, unamended statute. Therefore, if review is to be had, it must be obtained now.

The District of Columbia should be able to obtain review of the Court of Appeals' decision before it amends its statute. For these reasons, the decision of the Court of Appeals is final for purposes of review by this Court.

III. The District's Tax Has No Inherent Tendency to Benefit In-State Companies.

In its petition, the District argued that its tax does not inherently favor in-District companies because "a company does *not* always benefit by increasing its presence (i.e., its personal property) in the District." Pet. at 18; italics in original. We submitted a table and a graph to show "in a somewhat simplified form," Pet. at 18, that "in a great many circumstances, *increasing* either a company's property in the District, or its percentage of receipts in the District, *decreases* the amount of personal property sheltered from personal property taxes." *Id.*; italics in original. Respondents spend a great deal of space in their Opposition (at 6-11) arguing that our table and graph do not reflect the precise figures that result from applying the District's formula for calculating the personal property tax exemptions. We confess that we may have oversimplified. However, our simplification did not affect our point that, under the District's tax statute, increasing a firm's presence in D.C. (either its personal property or the percentage of its business) often does not produce a tax benefit. We set forth herein a table computing the precise amounts that would result from the application of the District's formula for computing the personal property exemption if two jurisdictions (the District and Maryland) both adopt the District's telephone tax statute. It shows, for example, that if

a firm has 40% of its business in the District, *increasing* its personal property in the District from 40 to 90% *decreases* the amount of its personal property sheltered from taxes in both jurisdictions from 100% to 50%. Similarly, if a firm has 40% of its personal property in the District, *increasing* the amount of a firm's business in the District from 40% to 90% *decreases* the amount of its personal property sheltered from taxes in both jurisdictions from 100% to 50%.

What application of the precise formula does emphasize is that a firm maximizes the amount of personal property sheltered from taxes in both jurisdictions if the percentage of its business and the percentage of its personal property in each jurisdiction is the same. But, as shown above, although that might influence to some extent business decisions as to where to do business, and even create some incentive to disperse business in several jurisdictions, neither consequence implicates the Commerce Clause.

The graph also shows that, even if a firm could predict and/or control the variables involved that govern how much of its property is sheltered from tax (but see our discussion, Pet. at 20-21), any incentives to disperse business are more modest than respondents pretend. Thus, the table shows the very broad range of distributions of property and gross receipts between two jurisdictions under which a company would shelter the vast majority of its property from personal property and sales and use taxes. With 40% of its gross receipts in the District, a company would shelter at least 70% of its property from taxation if anywhere from 10% to 70% of its property were in the District. Increasing the property in the District to 80% would mean that 60% would still be sheltered. The company with 40% of its business in the District would shelter at least 80% of its property from taxation if between 20% and 60% of its property were in the District. Similarly, if a com-

pany had 40% of its personal property in the District, at least 70% of its total personal property would be sheltered if its gross receipts attributable to the District remained between 10% and 70% of the total receipts from both jurisdictions.

As can be seen from these examples and from the table itself, very broad ranges of distributions of personal property and gross receipts among the jurisdictions where the companies do business permit a company to shelter a very high percentage of its property from taxation. Such distributions are likely to occur without regard to tax considerations. The companies are in the business of selling a service. The record indicates that they have a substantial presence in the jurisdictions where they sell those services.

What the table makes absolutely clear is that the District's tax scheme does not favor firms because they have a large presence in the District. This tax statute was not protective of in-state firms and does not favor, or even involve, intra-state commerce. There is no justification for holding that this tax statute violates the Commerce Clause.

CONCLUSION

This Court should clarify or reconsider the internal consistency test applied in *Tyler Pipe* in the context of this case. The 1987 District of Columbia law does not significantly burden interstate commerce and is much less burdensome than internally consistent alternatives.

Respectfully submitted,

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PERCENT OF TOTAL PROPERTY IN DISTRICT OF COLUMBIA

PERCENT OF FIRM'S CALLS TAXED IN D.C.	10%	20%	30%	40%	50%	60%	70%	80%	90%
0	90 ALL MD	80 ALL MD	70 ALL MD	60 ALL MD	50 ALL MD	40 ALL MD	30 ALL MD	20 ALL MD	10 ALL MD
10%	100 10% DC 90% MD	90 10% DC 80% MD	80 10% DC 70% MD	70 10% DC 60% MD	60 10% DC 50% MD	50 10% DC 40% MD	40 10% DC 30% MD	30 10% DC 20% MD	20 10% DC 10% MD
20%	90 10% DC 80% MD	100 20 DC 80% MD	90 20% DC 70% MD	80 20% DC 60% MD	70 20% DC 50% MD	60 20% DC 40% MD	50 20% DC 30% MD	40 20% DC 20% MD	30 20% DC 10% MD
30%	80 10% DC 70% MD	90 20% DC 70% MD	100 30% DC 70% MD	90 30% DC 60% MD	80 30% DC 50% MD	70 30% DC 40% MD	60 30% DC 30% MD	50 30% DC 20% MD	40 30% DC 10% MD
40%	70 10% DC 60% MD	80 20% DC 60% MD	90 30% DC 60% MD	100 40% DC 60% MD	90 40% DC 50% MD	80 40% DC 40% MD	70 40% DC 30% MD	60 40% DC 20% MD	50 40% DC 10% MD
50%	60 10% DC 50% MD	70 20% DC 50% MD	80 30% DC 50% MD	90 40% DC 50% MD	100 50% DC 50% MD	90 50% DC 40% MD	80 50% DC 30% MD	70 50% DC 20% MD	60 50% DC 10% MD
60%	50 10% DC 40% MD	60 20% DC 40% MD	70 30% DC 40% MD	80 40% DC 40% MD	90 50% DC 40% MD	100 60% DC 40% MD	90 60% DC 30% MD	80 60% DC 20% MD	70 60% DC 10% MD
70%	40 10% DC 30% MD	50 20% DC 30% MD	60 30% DC 30% MD	70 40% DC 30% MD	80 50% DC 30% MD	90 60% DC 30% MD	100 70% DC 30% MD	90 70% DC 20% MD	80 70% DC 10% MD
80%	30 10% DC 20% MD	40 20% DC 20% MD	50 30% DC 20% MD	60 40% DC 20% MD	70 50% DC 20% MD	80 60% DC 20% MD	90 70% DC 20% MD	100 80% DC 20% MD	90 80% DC 10% MD
90%	20 10% DC 10% MD	30 20% DC 10% MD	40 30% DC 10% MD	50 40% DC 10% MD	60 50% DC 10% MD	70 60% DC 10% MD	80 70% DC 10% MD	90 80% DC 10% MD	100 90% DC 10% MD
100%	10% ALL DC	20% ALL DC	30% ALL DC	40% ALL DC	50% ALL DC	60% ALL DC	70% ALL DC	80% ALL DC	90% ALL DC

PER CENT OF PERSONAL PROPERTY TAX AVOIDED (IN HYPOTHETICAL MD & DC)
WHERE MD HAS IDENTICAL TAX AS DC (FOR DIFFERENT COMBINATIONS OF DISTRIBUTION
OF PROPERTY AND TAXABLE CALLS)